

Book Reviews

Craig Burnside (ed.). *Fiscal Sustainability in Theory and Practice: A Handbook*. Washington, D. C.: World Bank. 2005. pp. xx+285. Price not given.

Fiscal sustainability is essential for economic growth and comprises a set of fiscal policies that result in financial solvency over the long run. As such, fiscal sustainability is the prime objective of the World Bank's Quality of Fiscal Adjustment Thematic Group (QFATG). It is a main issue in developing countries. The articles compiled from many journals here address fiscal sustainability analysis and the practical work undertaken by the Bank's Development Economic Research Group (DECRG) or Poverty Reduction Economic Management undertaken by the Economic Policy Group (PRMEG) and others. This book, basically a combination of economic theory and practical methods of analysis, provides a simple set of tools to assess a government's budget and debt position and is a comprehensive source of information on fiscal sustainability. It describes the effects of business cycles on public finance and examines the role of fiscal rule and currency crises and their impact on fiscal sustainability. Some basic concepts are explained, with solutions of complicated practical problems such as contingent liabilities, external debt position, and fiscal federalism.

Out of its nine chapters, the editor of the volume has written three; the principal author has written four chapters, while the remaining two chapters have been taken from other sources. Chapter 1 briefly describes the theme, the theory, and the tools and their application. Chapter 2 elaborates on theoretical prerequisites for fiscal sustainability analysis, defining sustainability as solvency, and assesses where a government is insolvent or is not. The results are based on the effect of government budget deficit and the coordination of monetary and fiscal policies under simple assumption about government debt. It shows that government's deficits are still inflationary even if the government does not default on its debt obligations. The chapter also highlights the impact of the stochastic shocks to government budget flows on goods prices, interest rates, the real economy, ability to borrow, policy responses, default magnitude, and its implications. The empirical analysis shows that the objective of low inflation and fiscal sustainability can only be achieved by coordinating the fiscal and monetary policies.

The tools for fiscal sustainability analysis are explained in Chapter 3. It describes the long-run fiscal sustainability conditions with practical examples of

Bulgaria, using a formal statistical test. The test determines the stock of initial debt relative to output, given particular values of flow variables. It explores further relationship with the government's stronger fiscal targets such as legal obligations and/or fiscal rules to achieve a particular debt target in steady state. Debt dynamics that examine the changes in the debt-to-GDP ratio in relation to the flows of government budget constraint are discussed in this chapter. The chapter also focuses on forward-looking fiscal sustainability analysis that includes currency risk, time-varying interest rates, and the effects of recessions.

Debt and debt indicators in the measurement of vulnerability are covered in Chapter 4. It includes the level of debt, types of debt, and debt assessment indicators to help predict crises and *ex ante* payment difficulties and defaults. The analysis helps in assessing the sustainability of national debt and vulnerability to exogenous shocks.

Chapter 5 highlights the concepts of cyclical adjustment and measurement issues of the budget. It is suggested that mostly the tax revenues collected from private income and personal consumption are pro-cyclical, while the proportion of government expenditure on modern transfer programmes is structurally counter-cyclical. Therefore, budget balance overestimates fiscal policy in expansion and underestimates in recession periods. The chapter describes the methods for cyclical adjustment of the budget balance including identification of trends and cycles as a measure of aggregate activity, the identification and decomposition of the cycles of budget data, and the relationship between the cyclical component of real activity and correction and estimation of the relevant budget data. It is pointed out that cyclically-adjusted data is useful in the context of fiscal sustainability, and helps the practitioners to determine the extent of the reflection of the current budget and exogenous shocks.

Chapter 6 provides a detailed case study of fiscal policy in Mexico between 1980 and 2003, and it is pointed out that Mexico's budget balance was counter-cyclical; it faced discretionary deficits during expansion and discretionary surpluses in the period of recession. The author concludes that fiscal shocks did not play a primary role in driving real activity. Its automatic stabilisers were weak because of its continuous reliance on revenues from petroleum that constitute one-third of the total revenue, while oil prices have tended to be counter-cyclical.

Fiscal rule is discussed in detail in Chapter 7, with the example of Chile in 2000, when it was applied then to deal with pro-cyclical fiscal policy. It discusses the implementation of the rule and preliminary assessment of its impact on Chilean economy, and sets targets for structural surplus at 1 percent of GDP.

Chapter 8 focuses on the issue of currency crises and fiscal sustainability, and points out that the fixed exchange rate regime will eventually collapse if government's initial debt exceeds the present value of its future primary surpluses. It emphasises the needs of controlling unanticipated increases in expenditure, of

overcoming higher inflation, and of maintaining a pegged exchange rate. This chapter explains the timings of crises and the consequences for inflation and depreciation, which depend on the nature of the government's monetary policy response to the crises.

The last chapter focuses on financing the cost of currency crises. It highlights the behaviour of prices in a post-crises environment, discusses the different financing strategies available to government, and presents a basic model of crises, with numerical examples to illustrate the different financing strategies.

The book is extremely useful for the students graduating in economics and public policy. It can be a useful reference for economists and policy-makers.

Kalbe Abbas

Pakistan Institute of Development Economics,
Islamabad.